



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
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IN REPLY REFER TO

PPD 730.5.45.1

June 30, 2005
05-PPD-046(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
DIRECTOR, FIELD DETACHMENT, DCAA

SUBJECT: Audit Guidance on Evaluating Compensation Costs

As briefed at the June 2005 Executive Steering Committee (ESC) meeting, based on the sample of audit reports reviewed as part of Policy's incurred cost project, the third highest amount of questioned costs in FY 2004 related to compensation costs (FAR 31.205-6) in the areas of reasonableness and executive compensation. This memorandum is to remind all regions and the Field Detachment of the audit risk associated with claimed compensation costs, and emphasizes the availability of the Mid-Atlantic Region Compensation Team, which has established an expertise and has had success in this area, for assistance in reviewing these costs.

Although Agency audit findings are not exclusively related to executive compensation, the bulk of findings stem from this area. Auditors are reminded that, when evaluating claimed executive compensation costs, the compensation cap limitations for the top five covered executives should not be construed as also being the reasonable levels of compensation. This is especially true for smaller contractors where executive compensation for the top five executives has been benchmarked to be reasonable at less than the cap limitation amounts (\$473, 318 for fiscal year 2005). Thus, despite the fact that contractors have voluntarily excluded some executive compensation costs from their incurred cost submissions to bring the total compensation claimed down to the appropriate cap amount, doing so does not mean that the cap amount is necessarily the reasonable amount for those executives. Reasonableness needs to be established using the FAR guidelines and appropriate benchmarking surveys and techniques.

Requests for review of compensation reasonableness can be forwarded by any FAO within the Agency to the Mid-Atlantic Region's compensation team for assistance in evaluation. Normally, larger contractors subject to Compensation System Reviews are not included as part of these requests unless deficiencies have been identified related to the compensation surveys used by the contractor. The compensation team is chartered to support total executive compensation evaluations for all regions. These evaluations include reviewing the allowability of executive compensation in accordance with FAR 31.205-6 compensation provisions in such areas as general allowability, reasonableness, bonuses, incentives, severance, fringe benefits, and deferred compensation. There is also a significant regional investment in purchased compensation surveys that can be used to evaluate the reasonableness of various elements of total executive compensation. In addition to being skilled at identifying and evaluating total executive compensation, the team also assists in resolving audit issues with contractors/consultants, and can serve as expert witnesses, when necessary.

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The enclosure to this memorandum contains a Contractor Data Form that should be used by FAOs for collecting data on a contractor's total executive compensation package that can then be forwarded to Mid-Atlantic's compensation team to begin their evaluation. The Mid-Atlantic team has identified that an accurately prepared data form, in conjunction with their experience in identifying and evaluating all elements of compensation, contributes to their proven best practice and is a key reason for their continued success in identifying and questioning unreasonable compensation costs.

Currently, the Mid-Atlantic team is responding to FAO requests for reasonableness evaluations within two to three weeks of receiving the completed Contractor Data Form. Typically, about six to eight hours will be charged to the cognizant FAO assignment for their evaluation effort, depending on the volume of executives and the number of years needing review. Whenever possible, all follow-up audit work should be accomplished by the cognizant regional compensation staff specialist, who will review and respond to contractor rebuttals and attempt to settle any audit issues. The completed data form should be submitted electronically to [DCAA-RSTCOMP-6](#).

CONCLUDING REMARKS

Field audit office personnel should refer questions regarding this memorandum to their regional offices. Regions unable to answer, or with questions of their own, should contact the Headquarters, Policy Programs Division, at (703) 767-2270, or e-mail at dcaa-ppd@dcaa.mil.

/Signed/

Robert DiMucci
Assistant Director
Policy and Plans

Enclosure:

Contractor Data Form

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